

Economic Indicators

Prepared by the Department of Finance • March 2004

The purpose of this report is to keep policy makers apprised of changes in the national and local economies that the Montgomery County Department of Finance believes may impact current and/or future revenues and expenditures.



*This report is also available through the Internet on the Montgomery County Web Page:
<http://www.montgomerycountymd.gov>*

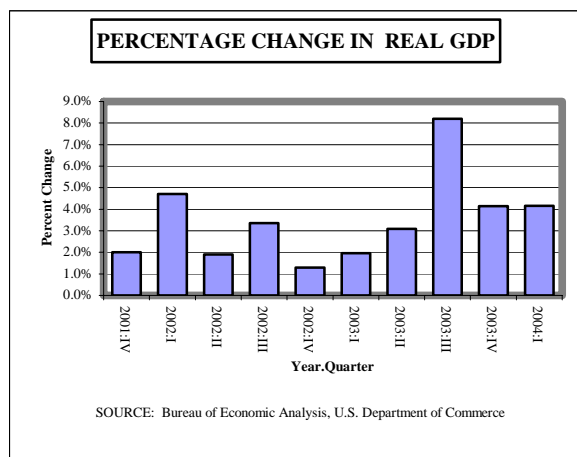
For questions regarding this report, please contact:

*David Platt
Chief Economist
Montgomery County Department of Finance
255 Rockville Pike, Suite L-15
Rockville, Maryland 20850*

*Phone: (240) 777-8866
Fax: (240) 777-8954
Email: David.Platt@montgomerycountymd.gov*

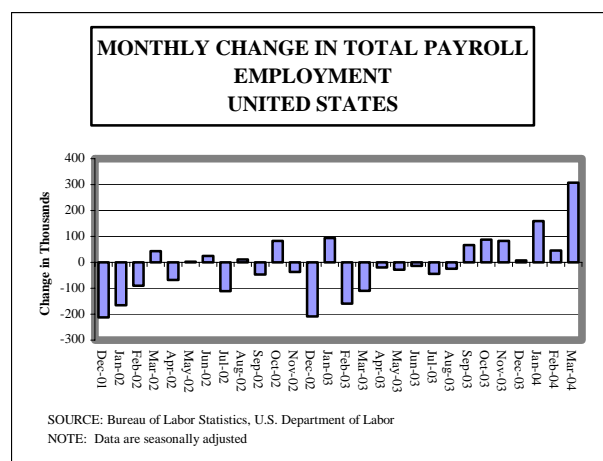
ECONOMIC OVERVIEW

According to the latest economic data, the U.S. economy continued to show vitality during the first quarter of 2004. Throughout the last half of 2003 and into the first quarter of this year, the economy has shown increasing signs of a sustainable expansion because aggregate demand has become broad-based with households, government, and firms making significant contributions. During the second half of last year, real GDP increased almost 6.2 percent and grew 4.2 percent during the first quarter of this year, according to advance estimates by the Bureau of Economic Analysis, U.S. Department of Commerce. If the growth rate for the first quarter holds, then the economy grew at an annual rate of 5.5 percent over the past three quarters and would be the largest growth rate since 1984.



Recent economic indicators support solid economic growth during the first quarter. Industrial production was up 2.9 percent compared to the first quarter of 2003. New orders for nondefense capital goods less aircraft were up 10.4 percent over the first quarter and 4.8 percent over the fourth quarter of 2003. Consumer confidence jumped 33.9 percent compared to the same period last year, and the chief

executive's confidence index rose to its highest level in over twenty years. Sales of new one-family homes increased 18.5 percent at a seasonally adjusted annual rate during the first quarter compared to the same period last year. Over 513,000 jobs were added to payroll employment, which was the largest quarterly gained since 2000, and retail sales increased 9.0 percent compared to the first quarter of 2003. The Federal Reserve maintained its accommodative policy of a 1 percent targeted federal funds rate.



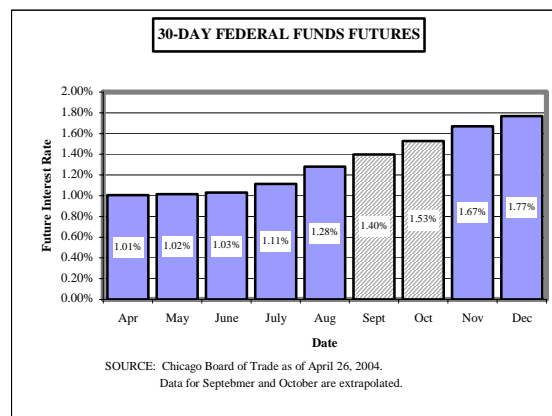
With such positive economic news across all sectors of the economy, the overriding issue in the coming months is whether interest rates will remain at their historically low levels. Inflation remains subdued yet recent increases in consumer and producer prices are such that concerns about disinflation expressed by Federal Reserve officials last year are moot. Inflation as measured by the Consumer Price Index for All Urban Consumers (CPI-U) increased 5.1 percent at a seasonally adjusted annual rate for the first three months of this year. This is the largest three-month increase since the same three-month period last year, but only the second time that the three-month annualized rate was above 5 percent in four years. While disinflation does not appear in the Fed's

forecast, neither does the recent inflation data suggest that the Fed will raise interest rates in the very near future. In his testimony before the Congressional Joint Economic Committee, Federal Reserve Chairman Alan Greenspan noted that although “the recent data suggest that the worrisome trend of disinflation has come to an end, productivity growth and a sizable margin of underutilized resources have checked any sustained acceleration of the general price level.”

Although the recent spurt in employment and inflation suggest that the economy may be expanding at an accelerated rate, the contention among Fed watchers is that the Federal Open Market Committee (FOMC) will wait for April and May employment and price data, at a minimum, before the FOMC will make any adjustment to the target rate on federal funds. Until employment and inflation exhibit a consistent and significant pattern of increases over the next few months, the FOMC is expected to maintain their current position of being “patient in removing its policy accommodation” at least through May. Before the meeting of the Bond Market Association, Federal Reserve Governor Ben Bernanke stated that “inevitably the funds will have to return to a more normal level.”

As a rule of thumb, market analysts consider a normal or neutral level for the federal funds rate to be about two percentage points above inflation. With core inflation running at 1.6 percent, such a neutral level means that the rate would increase from its current 1 percent to 3.6 percent. The issues are: 1) does the FOMC support a policy of a two-percentage-point spread between core inflation and a neutral federal funds rate, and 2) if so, how fast will the FOMC move to such a level.

Based on recent data from the Chicago Board of Trade (as of April 26, 2004), the futures market for 30-day federal funds expects a rate increase of 25 basis points in August followed by a significant rate increase by December 2004. As of April 22nd, the one-year Treasury bill rate increased almost thirty basis points since the end of March, and the two-year rate increased 55 basis points over the same period. The benchmark 10-year Treasury bond also increased nearly 55 basis points. These data suggest that the financial markets anticipate a series of rate hikes by the FOMC within the year.



With the 10-year Treasury bond jumping nearly 55 basis points in three weeks, the outlook for 30-year fixed mortgage rates suggests a similar though less rapid increase. In their latest economic forecast, the National Association of Home Builders (NAHB) estimate 30-year rates could increase from the current 5.9 percent to an average of 6.2 percent by the fourth quarter of this year. As such, they estimate that sales of new one-family homes are expected to decline from the current average of 1.2 million units for the first quarter to 1.0 million units by the fourth quarter.

The outlook for the national economy over the next three to six months remains positive. The U.S. leading economic indicators rose 0.3 percent in March from the prior month and 4.0 percent for the first quarter. Based on the recent forecast by the NAHB, real GDP is expected to grow 4.5 percent during the second quarter and consumer prices remaining subdued at an annual rate of 2.1 percent. Based on the results from its recent Industry Survey, the National Association for Business Economics expect employment to rise at an increasing rate, profit margins continue to expand during the second quarter albeit at a smaller rate compared to the first quarter, and capital spending will increase during the remainder of the calendar year.

In contrast to a strong economic performance during the first quarter, the stock market exhibited mixed results during this period. The Dow Jones and the NASDAQ declined 0.9 percent and 0.5 percent, respectively, while the S&P 500 and Russell 2000 increased 1.3 percent and 6.0 percent, respectively. Such a contrast in performance suggests that the stock markets have yet to establish a solid and consistent expectation of future earnings growth. Despite significant profit and economic news during the first quarter, there were a number of nagging concerns that troubled the market. Prior to the April jobs report that showed a significant boost in payroll jobs in March, the market had been disappointed in the employment situation. With the March jobs report showing no growth in the private-sector in February, the continuing threats of terrorism, and the turmoil in Iraq; the stock market declined dramatically through the first three weeks in March to levels in the month of December but rebounded slightly by the end of the month.

Similar to the national economy, which gained significant momentum during the second half of 2003 and the first quarter of 2004, the regional economy also expanded during the same period. According to the Center for Regional Analysis, the Washington Coincident Index, which represents the current state of the regional economy, grew a little over 1 percent in February and 4.3 percent since June of last year. Domestic passenger volume was up for the fourth time in five months, and the rapid increase in the area's job growth provides a significant indicator of the economy's acceleration. The latest metropolitan area employment report from the Bureau of Labor Statistics, U.S. Department of Labor, showed that the Washington area experienced an employment increase of over 60,000 jobs during the past year and was the largest increase among 274 metropolitan regions. The area's unemployment rate of 3.0 percent remains the lowest among the nation's major metropolitan areas.

Consumer spending in the Washington region also picked up in early 2004 with retail sales up 9.9 percent during the first two months of this year compared to the same period last year. Sales during the month of February alone increased 11.8 percent compared to last year. While retail sales in the region were up significantly, consumer prices remained subdued with the overall rate increasing 1.9 percent and the core inflation rate up only 1.5 percent, which was below the national rate. With employment and sales expanding during the early part of this year, the coincident economic indicator increased 4.7 percent compared to a 1.9 percent for the entire 2003.

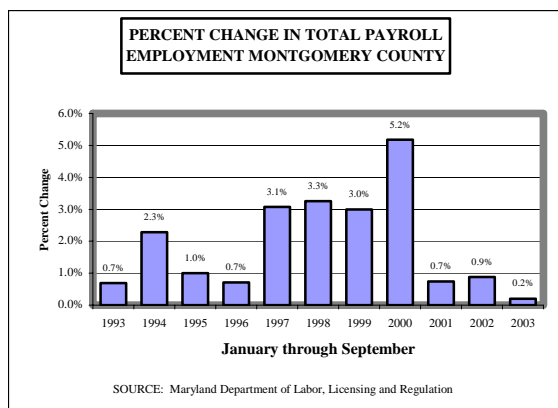
It is against this economic backdrop, at the national and regional level, that the

economic performance of Montgomery County is analyzed.

MONTGOMERY COUNTY ECONOMIC INDICATORS

Employment Situation

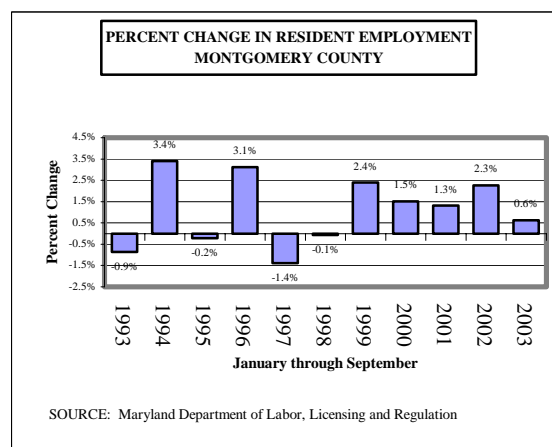
Data based on the latest establishment survey from the Maryland Department of Labor, Licensing and Regulation show meager employment growth between the first nine months of 2002 and the same period in 2003, the latest date for which data are available. Comparing average payroll employment between the two periods shows that employment grew only 0.2 percent, the lowest in over eleven years.



In comparison to the payroll data, resident employment during the same time period also increased a meager 0.6 percent. That rate of increase was significantly below the annual average rate of nearly 2.0 percent during the 1999-2002 period. Both data series indicate a weak employment picture for the County during the first nine months of 2003.

However, as the recent resident employment data show, the County experienced marked improvement in the labor situation during the last quarter of

2003 and first quarter of 2004. Resident employment increased by 11,840, or 2.4 percent, in March compared to March 2003. Such remarkable growth in resident employment is similar to the Washington area which grew 2.2 percent over the same period.



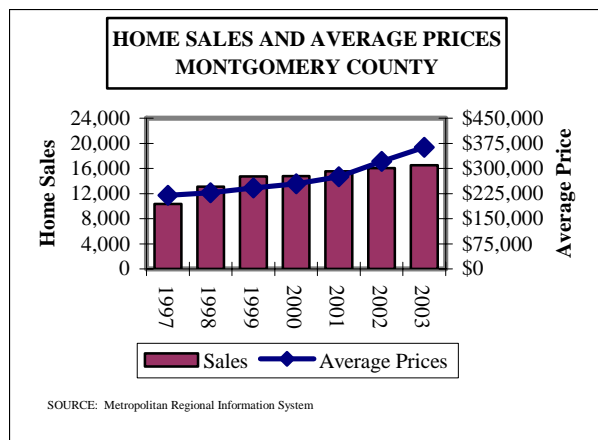
As resident employment improved during the past six months, the unemployment rate declined. With only a 2.2 percent unemployment rate in March 2004, the County's economy remains one of the strongest in the nation and is near full employment.

Residential Real Estate

Home sales in the County increased 2.9 percent in 2003, which is below the 3.8 percent average annual rate over the past three years, and significantly lower than the 16.4 percent during the 1997-99 period. While the growth in sales was modest, housing prices accelerated at a 13.2 percent rate in 2003. The average sales price of a home was over \$360,000 compared to less than \$220,000 in 1997.

The modest pace of home sales experienced in 2003 continued through the first quarter of 2004. While home sales

increased 11 percent in March, that rate offset declines in January (-0.1%) and February (-3.8%) such that sales for the entire quarter were only 2.9 percent higher compared to the same period last year. Average prices continued their meteoric rise during the first quarter, and if such a trend continues, they may surpass the 16.6 percent increase experienced in 2002.



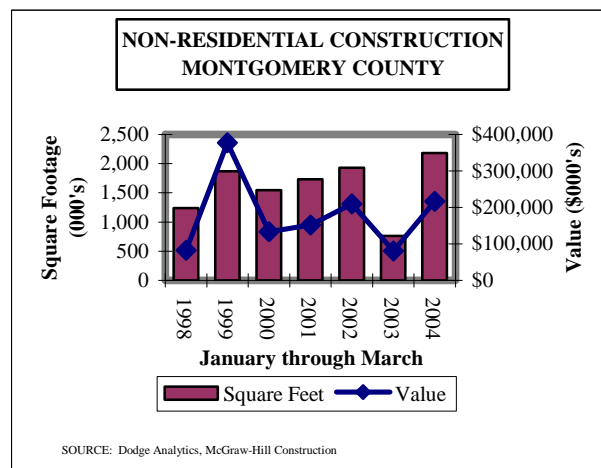
While such acceleration in housing prices may suggest a price bubble in the County, economic fundamentals suggest otherwise. The reason for the extraordinary price appreciation is attributed to economic and demographic factors. Over the past two years, approximately 6,300 single-family units were constructed in the County. During that same period, the number of households increased by 9,700. Therefore, within a two-year period, the increase in households (demand) exceeded the number of new single-family units (supply) by 3,400. The effect of such an imbalance means that the acceleration of home prices may continue until such time that demand and supply come into balance.

Construction

Construction activity in the County declined dramatically during 2003. The value of new residential and nonresidential

construction dropped 29.3 percent and 55.5 percent, respectively. The number of residential projects declined 49.3 percent, and the amount of new square footage of commercial space declined 50 percent from 2002 levels.

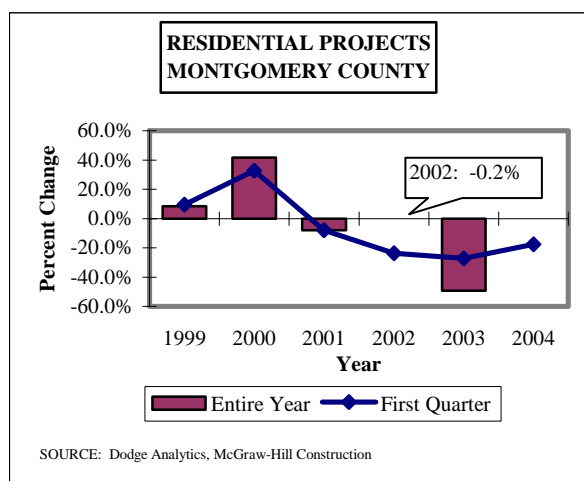
However, after a sharp drop in construction, the first three months of 2004 show a different picture. Nonresidential construction activity picked up between January and March with both the amount of square footage and value almost tripling. Construction activity this past quarter surpasses the level of activity the same period during the previous six years.



Residential construction activity experienced mixed results. The value of new construction increased nearly 9 percent during the first quarter of this year, but the number of new homes continued to decline. While such a decline may be attributed to seasonal factors, construction during the first quarter portends activity for the rest of the year. Since 2001, the decline in residential construction during the first quarter also resulted in a decline for the entire year.

Over the past five years, the number of residential projects declined from slightly over 1,100 units during the first quarter of

2000 to less than 470 units during the same period this year, a drop of almost 60 percent. With such a decline in the amount of residential construction in the County and the increased level of demand noted in the previous section, the result is that demand and supply are seriously out of balance. Unless such imbalance is improved, the gap between the amount of housing supply and expected demand will continue to widen, thereby creating a continuation of price appreciation in the near term.

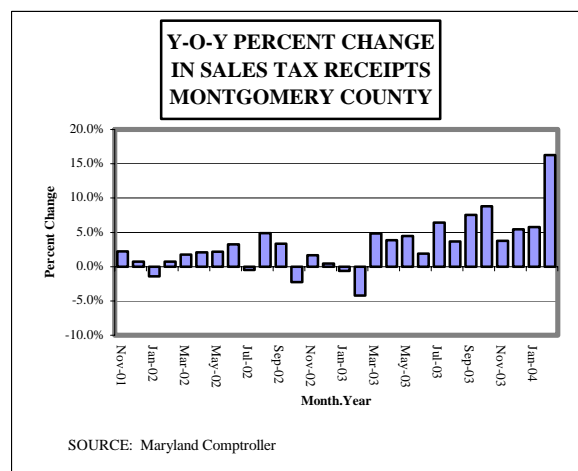


According to the latest data from the Bureau of the Census, U.S. Department of Commerce, residential housing permits for the County increased almost 13 percent in March. While that figure may be encouraging, the fact remains that through the first quarter, total residential building permits were down over 40 percent compared to the same period last year, a period that experienced a harsh winter. The issue is whether the March rebound or the quarterly decline is the better indicator of future residential construction.

Retail Sales

Retail sales in the County, as measured by sales tax receipts, rebounded nicely in

February compared to the same month last year. Compared to last year, sales increased 15.6 percent and match the double-digit increases experienced in the region and in the state. Based on data for the first two months of this year, sales have increased two and a half times the level during the same period in 2003. While the harsh winter of last year dampened retail sales during the January to February timeframe, the dramatic increase in sales can also be attributed to a rebound in consumer confidence and the fiscal stimulus attributed to tax refunds.



Sales among nondurable and durable goods increased in February. Sales of industrial supplies (+26.8%), apparel (+17.6%), general merchandise (+12.4%), led the increase. Purchases of furniture and automotive products also experienced significant gains.

Energy Prices

Although data from the regional consumer price index suggest that inflation remained subdued over the past year, energy prices have had a significant effect on a household's disposal income. Since the end of December, the average price of regular gasoline increased from \$1.53 per gallon to

almost \$1.80 gallon for the Central Atlantic region. According to recent remarks by Fed Governor Bernanke, energy prices have reduced households' real disposable income by about \$30 million since December. This decline translates into approximately \$410 per household. Applying that rate to Montgomery County households, the amount of disposable income lost to higher energy prices is estimated at almost \$140 million through the first quarter.

SUMMARY

The County's economy showed mixed results during the first quarter of 2004. Significant features were:

- The unemployment rate dropped to 2.2 percent in March to its lowest level since May 2001 suggesting that the County may be near full employment.
- Although energy prices, particularly gasoline prices, have increased dramatically since December, core inflation remains below 2 percent.
- Non-residential construction increased during the first quarter 2004 compared to the same period last year and suggests that construction activity should improve through the remainder of the year.
- Construction of new single-family homes is falling behind demand and suggests that such an imbalance will keep prices accelerating through the year.
- Sales of homes in the March increased significantly after a weak January and February period.

SELECTED ECONOMIC INDICATORS	Reporting Period	Current Period	Prior Year's Period	Year To-Date		2003
				2004	2003	
Leading Indicators						
National	Mar	0.3%		4.0%		3.0%
Washington MSA	Feb	-0.8%		3.0%		2.5%
Coincident Indicators						
National	Mar	0.2%		1.7%		1.1%
Washington MSA	Feb	1.2%		4.7%		1.9%
Consumer Confidence Index						
National	Apr	5.0%		28.5%		13.6%
South Atlantic Region	Apr	-1.3%		28.2%		16.5%
Consumer Sentiment (University of Michigan)	Apr	-2.7%		18.8%		6.8%
Consumer Price Index						
All Items (nsa)						
National	Mar	1.7%		1.8%		2.3%
Washington - Baltimore CMSA	Mar	1.9%		2.0%		2.8%
Core CPI (nsa)						
National	Mar	1.6%		1.3%		1.5%
Washington - Baltimore CMSA	Mar	1.5%		1.4%		2.4%
Retail Trade						
National (sales - nsa)	Mar	10.2%		9.0%		5.6%
Washington MSA (sales - nsa)	Feb	11.8%		9.9%		6.5%
Maryland (sales tax)	Feb	18.9%		12.6%		3.5%
Montgomery County (sales tax)	Feb	15.6%		10.3%		4.0%
Employment						
National (household data - nsa)	Mar	137,691,000	136,783,000	137,333,000	136,374,333	137,736,000
- Percent Change		0.7%		0.7%		0.9%
Washington PMSA (household data - nsa)	Mar	2,804,263	2,744,226	2,790,680	2,726,694	2,763,091
- Percent Change		2.2%		2.3%		1.6%
Montgomery County (resident)	Mar	500,234	488,401	498,451	487,170	495,052
- Percent Change		2.4%		2.3%		1.1%
Montgomery County (payroll)	Sept. '03	450,398	450,285	448,716	447,833	449,195
- Percent Change		0.0%		0.2%		0.7%
Unemployment						
National (nsa)	Mar	6.0%	6.2%	6.1%	6.4%	6.0%
Maryland (nsa)	Mar	4.0%	4.9%	4.3%	4.8%	4.3%
Washington PMSA	Mar	3.0%	3.6%	3.2%	3.6%	3.4%
Montgomery County	Mar	2.2%	2.7%	2.4%	2.8%	2.5%
Construction						
Construction Starts - Montgomery County						
Total (\$ thousand)	Mar	\$161,390	\$59,233	\$337,327	\$190,811	\$949,138
- Percent Change		172.5%		76.8%		-42.7%
Residential (\$ thousand)	Mar	\$21,562	\$41,642	\$120,298	\$110,520	\$567,664
- Percent Change		-48.2%		8.8%		-29.3%
Non-Residential (\$ thousand)	Mar	\$139,828	\$17,591	\$219,029	\$80,291	\$381,474
- Percent Change		694.9%		172.8%		-55.5%
Building Permits (Residential)						
National	Mar	183,559	143,525	444,236	391,197	1,862,365
- Percent Change		27.9%		13.6%		6.6%
Maryland	Mar	2,312	2,132	5,904	5,931	30,125
- Percent Change		8.4%		-0.5%		2.8%
Montgomery County	Mar	307	272	908	1,521	4,590
- Percent Change		12.9%		-40.3%		-8.4%
Building Permits (Non-Residential)						
Montgomery County	Mar	156	159	426	411	1,798
- Percent Change		-1.9%		3.6%		-3.2%
Real Estate						
National (saar)						
Sales	Mar	6,480,000	5,750,000	6,200,000	5,820,000	6,100,000
- Percent Change		12.7%		6.5%		9.6%
Median Price	Mar	\$174,100	\$162,100	\$170,800	\$160,367	\$170,000
- Percent Change		7.4%		6.5%		7.5%
Montgomery County						
Sales	Mar	1,218	1,097	3,066	2,981	16,534
- Percent Change		11.0%		2.9%		2.9%
Average Price	Mar	\$388,550	\$331,415	\$386,595	\$328,645	\$362,997
- Percent Change		17.2%		17.6%		13.2%
Median Price	Mar	\$324,140	\$271,000	\$317,438	\$263,667	\$295,500
- Percent Change		19.6%		20.4%		15.5%
Average Days on the Market	Mar	28	35	32	36	27

METROPOLITAN AREA OFFICE MARKET

Office Vacancy Rate by Jurisdiction and Class, 03/04

<i>Jurisdiction</i>	Class A	Class B	Class C	Total
Loudon	15.60%	13.58%	5.32%	14.31%
Fairfax	14.56%	12.38%	6.99%	13.67%
Frederick	8.21%	5.92%	10.14%	7.45%
Alexandria/Arlington	10.18%	10.38%	3.96%	9.35%
Montgomery	10.66%	10.13%	7.10%	10.10%
District of Columbia	7.10%	7.25%	7.76%	7.23%
Prince George's	11.68%	10.74%	8.36%	10.80%
<i>Metropolitan Area</i>	10.99%	9.78%	6.81%	10.18%

Vacant Office Space Inventory by Jurisdiction and Class (sq.ft.)

<i>Jurisdiction</i>	Class A	Class B	Class C	Total
Loudon	908,569	465,507	29,260	1,403,336
Fairfax	9,851,803	3,536,635	241,833	13,630,271
Frederick	173,567	104,606	41,353	319,526
Alexandria/Arlington	2,482,217	1,836,120	281,676	4,600,013
Montgomery	3,478,903	2,268,311	450,933	6,198,147
District of Columbia	4,359,764	3,060,973	977,455	8,398,192
Prince George's	1,154,238	849,787	280,056	2,284,081
<i>Metropolitan Area</i>	22,409,061	12,121,939	2,302,566	36,833,566

Office Space Inventory by Jurisdiction and Class (sq.ft.)

<i>Jurisdiction</i>	Class A	Class B	Class C	Total
Loudon	5,826,022	3,428,941	550,242	9,805,205
Fairfax	67,675,158	28,560,833	3,458,262	99,694,253
Frederick	2,113,317	1,768,406	407,752	4,289,475
Alexandria/Arlington	24,372,789	17,694,325	7,105,211	49,172,325
Montgomery	32,640,112	22,392,025	6,349,234	61,381,371
District of Columbia	61,398,999	42,197,236	12,595,191	116,191,426
Prince George's	9,882,591	7,912,611	3,351,317	21,146,519
<i>Metropolitan Area</i>	203,908,988	123,954,377	33,817,209	361,680,574

Share of Office Space Inventory by Jurisdiction and Class

<i>Jurisdiction</i>	Class A	Class B	Class C	Total
Loudon	59.4%	35.0%	5.6%	100.0%
Fairfax	67.9%	28.6%	3.5%	100.0%
Frederick	49.3%	41.2%	9.5%	100.0%
Alexandria/Arlington	49.6%	36.0%	14.4%	100.0%
Montgomery	53.2%	36.5%	10.3%	100.0%
District of Columbia	52.8%	36.3%	10.8%	100.0%
Prince George's	46.7%	37.4%	15.8%	100.0%
<i>Metropolitan Area</i>	56.4%	34.3%	9.4%	100.0%

Note:

Office Space inventory includes leasable and owner-occupied space.
 Totals exclude non-classified space.
 Vacant means "direct vacant" and does not include sublease space.

Source:

Montgomery County Department of Planning, Research and Technology Center
 Data compiled from Realty Information Group commercial space data file, 03/10/04